VZCZCXRO9434
RR RUEHCHI RUEHDT RUEHHM RUEHNH
DE RUEHKL #1005/01 1590821
ZNR UUUUU ZZH
R 080821Z JUN 07
FM AMEMBASSY KUALA LUMPUR
TO RUEHC/SECSTATE WASHDC 9430
INFO RUCNASE/ASEAN MEMBER COLLECTIVE
RHMFIUU/US CUSTOMS AND BORDER PROTECTION WASHINGTON DC
RUEATRS/DEPT OF TREASURY WASHINGTON DC
RUEHRC/USDA FAS WASHDC
RUCPDOC/DEPT OF COMMERCE WASHDC

UNCLAS SECTION 01 OF 05 KUALA LUMPUR 001005

SIPDIS

SENSITIVE
SIPDIS

STATE PASS USTR -- WEISEL AND JENSEN
USDOC FOR 4430/MAC/EAP/J.BAKER

E.O. 12958: N/A
TAGS: ECON EINV ETRD EWWT EAIR MY
SUBJECT: SURFING IN SINGAPORE'S WAKE: MALAYSIA'S ISKANDAR
DEVELOPMENT REGION

REF: A. KUALA LUMPUR 61
¶B. KUALA LUMPUR 787

¶1. (SBU) Summary. Malaysia's government hopes to accelerate investment in the southern state of Johor with its planned Iskandar Development Region (IDR). The government's public statements portray IDR as a new approach that will attract global firms for "knowledge-based" investment, but econoff's recent tour of the project area suggests it really is aimed at further exploiting Johor's proximity to Singapore. Johor already benefits from its location and also is receiving a large inflow of money for infrastructure from the GOM's Ninth Malaysia Plan. New investment incentives under IDR would provide the main stimulus for any additional new development. The government's initial list of incentives applies only to a few sectors of limited interest, but suggested the possibility of exemptions in certain cases from the long-standing equity requirements of Malaysia's racial preference policy. The final list of incentives is scheduled to be announced this fall, but the government does not appear to be prepared to take big political risks to ensure the success of this development initiative. End summary.

Launching the Iskandar Development Region

¶2. (U) Prime Minister Abdullah Badawi launched the Iskandar Development Region (IDR) in November 2006. Named for the Sultan of Johor, IDR is more an investment incentive plan than a development plan. Southern Johor already is well developed, with a per capita GDP significantly higher than Malaysia as a whole. The GOM had previously committed through its Ninth Malaysia Plan to spend 4.3 billion ringgit (approximately USD 1.3 billion) for infrastructure projects in Johor up through 2010.

¶3. (SBU) State investment agency Khazanah has created the Iskandar Regional Development Authority (IRDA) to oversee the IDR's activities, and issued a comprehensive development plan (CDP) to guide the project's activities over the next 20 years. IRDA's Ismail Ibrahim told econoff that a prime role of IRDA will be to promote foreign investment, in part by directly assisting foreign firms in meeting foreign investment requirements within the IDR. Ismail is one of a handful of Khazanah staff working to get IRDA off the ground, but he expects the authority to expand exponentially, in particular once the full IDR investment incentive package is announced in September. Ismail hinted to econoff that the September announcement will revolve more around (hopefully)

announcing some high-profile foreign investments than around a long list of new incentives.

¶4. (U) A March 2007 announcement of proposed incentives attracted much attention, mostly due to a possible exemption from Malaysia's race-based preference program for a limited range of foreign investments. (Note: Malaysia's long-standing Bumiputera Policy requires that ethnic Malays and indigenous peoples be given at least 30% equity interest in such new business; see ref B). Other incentives announced in March included a 10-year corporate tax exemption, and the ability for foreign investors to source capital globally to employ foreign workers. However, these initial incentives only apply to business activities within the IDR and/or outside Malaysia, and only in six services sectors: education, healthcare, creative industries, financial advice and consulting, logistics, and tourism.

Location, Location, Location

¶5. (U) The CDP acknowledges that the IDR's success will depend heavily on its geographic proximity to Singapore and, to a much lesser extent, Indonesia. The IDR extends almost the full length of Malaysia's border with Singapore along the Straits of Johor, incorporating the city of Johor Bahru (Malaysia's second largest city) in the center, extending to the major seaports in the east (Pasir Gudang/Tanjung Langsat) and west (Tanjung Pelepas) and north of Johor Bahru to incorporate the Senai airport area. Nearly 60 percent of the IDR's 2217 square kilometers currently is agricultural land, providing a large reserve for long term development. However, the CDP envisions most of the development in the early years concentrating in five "flagship zones" consisting

of the city of Johor Bahru, the two seaports, Senai airport, and the Nusajaya development west of Johor Bahru. Since these areas already have adequate infrastructure in place (or, in the case of Nusajaya are being constructed already), IRDA foresees IDR projects starting there and eventually expanding into outlying areas.

¶6. (U) The CDP acknowledges that "development within (Singapore and Indonesia) will have significant impact on the development of the (IDR)." The CDP assumes Singapore will reach the limits of its ability to develop its land and sea space and will be forced to encourage its labor- and land-intensive and lower value added industries to move to Johor, as well as Batam, Indonesia to the south. The CDP notes with admiration Batam's vibrant offshore manufacturing activity due to its proximity to Singapore, and suggests that IDR will be poised to benefit in a similar way.

¶7. (SBU) Indonesia currently is a significant source of labor for Johor's manufacturing and services sector, but the CDP foresees Indonesia, in particular Sumatra, establishing stronger investment links with Johor to take advantage of improved transportation linkages. The plan envisions enhanced bilateral cooperation in such sectors as tourism, agro-processing, construction and port services. Comment: The CDP understandably makes no mention about the future role of Indonesian laborers as IDR is implemented. Indonesian laborers will undoubtedly remain in strong demand, in particular during the early years of development with the construction of large-scale infrastructure projects. End comment.

A Delicate Dance with Singapore

¶8. (U) The CDP calls for the IDR to be planned and created as an integrated development together with Singapore and Indonesia. To that end, Malaysian Prime Minister Abdullah Badawi and Singapore Prime Minister Lee Hsien Loong announced

on May 15 the creation of a ministerial-level joint committee to oversee certain areas of cooperation in the IDR. Abdullah hinted that easier access by Singaporeans to the IDR would be one such issue tackled by the committee. Although the CDP initially envisioned that certain parts of the IDR would provide free access to Singaporeans, subsequent criticism in Malaysia caused the GOM to rescind the proposal (which presumably would have allowed any Singaporean citizen to freely enter the IDR) in favor of more limited rules to ease access to pre-approved Singaporeans. In an effort to placate public criticism that the joint committee would impinge on Malaysia's sovereignty, Abdullah stressed that it would not have authority over the IRDA's investment decisions, including investm
ents from Singapore.

¶9. (SBU) On a visit to Johor in late May, econoff found little reluctance among local developers about touting Johor's advantage of being situated next to Singapore. Unlike the politicians in KL, Malaysians directly involved in the development of the IDR flagship zones were much more sanguine and realistic about Johor's dependence on Singapore for its prosperity, both past and future. The general attitude expressed to econoff in a variety of meetings was that Johor's future economic development was not tied to the IDR (and in fact was a given, since Singapore was right next door), but that the IDR would provide incentives for additional investment that might have gone elsewhere. Our interlocutors generally expressed interest in attracting more manufacturing and infrastructure projects. However; there was little mention of transforming Johor into a hub of "knowledge-based" economic activity as some Malaysian leaders have suggested.

Nusajaya -- City of the Future?

¶10. (SBU) Of the five IDR flagship projects, Nusajaya best exemplifies the type of new economic activity that the IDR is designed to encourage. Like the other flagship projects, Nusajaya predates the IDR itself. Unlike the other four, however, Nusajaya is still largely in the initial development stage. The Johor State New Administrative Center in Nusajaya should open its first buildings by the end of 2007 and

eventually will house all state government offices, as well as the Johor branches of federal government offices. Zamry Ibrahim, General Manager for the Nusajaya project, told econoff that project developer UEM Land is satisfied with the pace of development, which he expects will accelerate once the Johor State government buildings (which include the Chief Minister's offices and the state parliament) are open. On a tour of Nusajaya's 24,000 acres, Zamry pointed out the significant infrastructure improvements that UEM Land already has made. For example, the new government offices are being constructe
d far inland from the feeder highway, necessitating significant road construction to allow access. A few residential subdivisions have opened, though with few occupants so far. Zamry noted that many of the half-acre plots in the initial subdivisions have been sold, mostly to Singaporeans. In addition, UEM Land has undertaken a massive excavation project on a large tract of land between the new government buildings and the Straits of Johor, which will form a large marina and waterfront project, blending housing, retail and tourist facilities.

¶11. (SBU) Zamry indicated that Nusajaya's traditional development projects are progressing well, but one ambitious goal -- a "creative and entertainment hub" -- remains somewhat undefined. The CDP calls for a hub dedicated to the digital content industry, but Nusajaya officials seem perplexed about what sorts of business this would involve. On the entertainment side, however, Zamry said UEM Land has held talks with several theme park operators and is

optimistic about announcing a deal by the end of 2007. Comment: Although the creative industries sector is targeted by the IRDA as one of six sectors to receive special investment incentives to promote its development, the CDP is unclear about the particular types of creative industries that should be targeted. The plan makes no mention of Malaysia's continued difficulty in enforcing intellectual property protection, nor of its reluctance to adhere to many multilateral IP treaties -- actions that would be key to enticing IP-dependent firms to Malaysia. End comment.

Johor's Sea and Air Ports -- Alternatives to Singapore
--- ---------

¶12. (U) Since opening in 1999, Johor's Port of Tanjung Pelepas (PTP) has expanded rapidly and now handles approximately the same amount of containerized cargo as Kuala Lumpur's Port Klang (which incorporates two port complexes, West Port and North Port). Khairul Anuar Othman of PTP told econoff the port expects to handle approximately 5.3 million TEUs (twenty-foot equivalent units, a measurement of containerized cargo) in 2007. This places PTP among the top 20 containerized ports in the world, although it still pales in volume compared to nearby Singapore, which handles about 23 million TEU annually.

¶13. (U) Unlike Port Klang, some 95% of PTP's business consists of transshipment between other ports, though Khairul noted that PTP is planning for expanded domestic-origin container traffic as Johor develops further. PTP is a regional hub for both Maersk and Evergreen, and those two companies' operations form the bulk of the workload of the two U.S. Container Security Initiative officers stationed at PTP. Like Port Klang, PTP has a free zone that permits duty free operations as well as 100% foreign ownership of equity. The existing free zone includes a variety of logistics firms in a 400 acre "free commercial zone", as well as some high profile new manufacturing firms in the 600 acre "free manufacturing zone", including U.S. electronics manufacturer Flextronics, contact lens firm CIBA Vision, and a BMW parts distribution center. PTP recently began making preparations to more than double the size of the port's free zone, which is also a key component of the IDR.

¶14. (SBU) Johor's two other ports to the east of Johor Bahru handle alternate types of shipments. Johor Port in Pasir Gudang is the state's former leading port, and now handles multi-purpose goods, including liquid bulk (mainly palm oil), plus a small amount of containerized traffic. A third port, Tanjung Langsat (TL), is being constructed further east of Pasir Gudang by Johor Corporation, the state-owned development conglomerate which had earlier developed Pasir Gudang. Tanjung Langsat will be a major shipper of both

petrochemicals and oleo chemicals upon its completion, and the port is developing a "biofuel park" that aims to become a major processor for palm oil (Pasir Gudang currently contains the largest percentage of such refineries in Malaysia -- the Biofuel Park at TL would supplement the existing facilities). Fuad Omar of Johor Corporation told econoff that TL will provide more efficient shipping than Johor Port for the increasing volume of palm oil exports from Johor State. TL is located at the eastern end of the Straits of Johor, near the shipping lanes that run offshore Singapore (PTP takes advantage of a similar position on the western end of the Straits). Fuad noted, however, that Singapore's reclamation of land directly across from the TL development, off the largely uninhabited Singaporean island of Tekong, has the potential to inhibit the port's future development by restricting the ability of ships to maneuver into and out of the port (Fuad implied that Singapore was deliberately trying to impede the port's development).

¶15. (U) The third point of the IDR "logistical triangle" is Senai Airport to the north of Johor Bahru. Hariss Abdullah of Senai Airport Terminal Services told econoff that the airport's 10 year development plan includes an upgrading of its cargo facilities to make the airport a realistic alternative to Singapore's Changi airport. Much air cargo originating in Johor now departs via Changi (even from some of the technology firms situated close to Senai), and Senai wants to capture a share of the business. The airport soon will launch a free zone within its boundaries to encourage further development of both logistics and manufacturing operations. Hariss told econoff the airport would welcome direct flights by U.S. cargo carriers, and believes its location provides all the advantages of Changi at lower cost, though so far U.S. carriers have not expressed interest. Hariss added that the airport also hopes to capture an increasing share of the region's passenger market, and has embarked on a major refurbishme
nt and expansion of its passenger facilities. Senai is benefiting from its position as an expanding regional hub for Air Asia, Malaysia's discount air carrier.

IDR Beneficiaries -- The Usual Suspects are First in Line
-- ------------

¶16. (SBU) The IDR "flagship zones" slated for the bulk of activity in the development's early phases are dominated by several well-known (and well-connected) Malaysian firms. UEM Group, which is developing Nusajaya, is a prominent construction and engineering firm, and a wholly-owned subsidiary of Khazanah, the government's state-owned investment arm that is the driving force behind the IDR. Johor Corporation, which developed Pasir Gudang and is now developing Tanjung Langsat, was set up in the early 1970s to push development projects to benefit the state's Bumiputera. MMC, owned by Syed Mokhtar Al-Bukhary (Malaysia's richest ethnic Malay), has a 70% controlling interest in PTP, owns 100 % of Johor Port, and its wholly-owned subsidiary Senai Airport Terminal Services runs Senai Airport (the only major Malaysian airport that is privately run). Note: Another firm owned by Syed , SKS Ventures, reportedly signed a contract in late 2006 with the National Iranian Oil Company to develop gas fields in Iran, an ac
tion that has raised concerns under the Iran Sanctions Act (see ref A). End note.

Comment

¶17. (SBU) While the IRDA has published slick brochures with somewhat detailed implementation plans, it remains to be seen whether the IDR can attract significant investment in the type of knowledge-based industry that Malaysian officials most desire. Other similar initiatives, such as the Cyberjaya Multimedia Super Corridor outside Kuala Lumpur, so far have failed to live up to expectations. It appears more likely that IDR incentives will, in the initial years, foster Johor's continued development as a manufacturing outsource center for foreign firms, in particular from Singapore as well as Japan and the United States. The CDP itself encourages such activity, at least in the early years of the IDR project.

¶18. (SBU) All the current major projects underway in southern

Johor predate the advent of the IDR. Moreover, most of the current activity involves traditional Malaysian economic development -- heavy on infrastructure projects like roads, ports, buildings, in addition to manufacturing. So far the usual crowd of powerful business interests, like MMC, UEM and Johor Corporation, are poised to be the principal beneficiaries of the nascent IPR. Such favoritism may be excused if IPR really does take off and become a major source of foreign investment, especially if such investment takes place in more innovative sectors. There is little evidence

that suggests this will happen in the near term.

¶19. (SBU) Political constraints, in particular the GOM's longstanding Bumiputera preference program, will certainly give pause to potential foreign investors. Even the suggestion that the government might relax preference requirements in a few sectors has generated widespread public criticism. It seems unlikely the GOM will offer significantly broader liberalization when the full IDR incentive and support package is announced in the fall. The government's hasty abandonment of proposed free access for Singaporeans in certain parts of the IDR showed its reluctance to take politically risky moves, despite the fact that the IDR's success could depend on its attractiveness to Singaporean investors.

The Demographic and Economic Contexts - Somewhere between KL and Singapore
-- -----------------

¶20. (U) The Iskandar Development Region (IDR) has a population of 1.35 million, about 43% of the total population of Johor. Malays constitute about 48% of the population, with the Chinese as the next largest ethnic group at 36%, followed by Indians at 9.4%. Chinese in Johor thus have a higher profile than in Malaysia as a whole, where they constitute 24% of the population compared to the Malays 61%. The IDR's per capita GDP (at purchasing power parity) was USD 14,790 in 2005, significantly higher than the Malaysian average of USD 10,318, but less than half that of Singapore's per capita GDP of USD 29,937. The services sector contributes more to the GDP of the IDR than does the manufacturing sector (50% versus 47%, with agriculture taking the remaining 3%). Wholesale and retail trade makes up 47% of the services sector, followed by tourism and hospitality at 17% and professional and business services at 15%. The manufacturing sector is dominated by the electrical and electronics industries (32%) followed by chemical and chemical products (12%) and food and beverages (11%).
SHEAR